

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

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Electricity Market Design and Structure

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) Docket No. RM01-12-000  
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**Comments of  
The Electricity Consumers Resource Council  
On the Working Paper on Standardized Transmission Service  
And Wholesale Electric Market Design**

The Electricity Consumers Resource Council (ELCON) submits these comments in response to the Commission’s *Working Paper on Standardized Transmission Service and Wholesale Electric Market Design*. Our comments will focus on several threshold issues addressed in the *Working Paper*: (1) standardized transmission service; (2) demand response; (3) the specification of financial transmission rights as both “obligations” and “options;” (4) the need for bidding rules that restrain generator market power in bid-based markets and promote a robust, liquid forward market; (5) the initial allocation of FTRs; (6) market monitoring and mitigation; and (7) RTO governance.

**1. Single, Flow-based Transmission Tariff**

ELCON applauds the Commission for recognizing the need to reform Order 888 and the underlying structure of that Order’s pro forma open-access tariff. We strongly support the Commission’s intent to bring all use of the transmission system under a single, flow-based tariff administered by an independent RTO. This corrects what is arguably the most egregious omission in FERC’s policy to promote competitive bulk power markets in the United States—the failure to establish true comparability of access to the interconnected grid whereby all transmission customers are served under the same rules, rates, terms and conditions.

**2. Demand Response**

We equally applaud the Commission’s intended treatment of demand response as a resource with rights of access to RTO energy and capacity markets that equal access traditionally

enjoyed only by generation (supply) resources. If a *competitive* bulk power market is the desired end-state of the Commission's policy, price-responsive demand response must have non-discriminatory access to any and all markets (bid-based or otherwise) that are available to generation resources. We commend the Commission's choice of words in describing the eighth of eleven principles for guiding the development of standard market design:

8. Demand response is essential in competitive markets to assure the efficient interaction of supply and demand, as a check on supplier and locational market power, and as an opportunity for choice by wholesale and end-use customers.  
*Working Paper, Page 6.*

However, one important clarification is necessary. This regards compensation. The *Working Paper* is generally silent on compensation for demand resources, although, the spirit of the document clearly intends for demand resources to be compensated on an equal and comparable ("not unduly biased") basis with supply resources. Demand response as a resource will not happen unless customers with price-responsive loads are compensated on the same basis as any generator. We urge the Commission to quickly clarify this issue to avoid the need to further fight this matter separately in each RTO tariff proceeding.

In addition, the pending NOPR should address the mechanics of price determination that are applicable to both supply and demand resources, *i.e.*, the price at the margin for a unit decrement of demand response must be calculated in the same manner as the price for a unit increment of supply. The prices must not be the result of two separate protocols, procedures or software packages.

### **3. FTRs As Obligations and Options**

Next, ELCON supports the attempt in the *Working Paper* to add some consumer-oriented flexibility to the design of the market for financial transmission rights (FTRs) by specifying such rights as both obligations and options. Existing markets that limit FTRs to obligations lack liquidity in the forward markets that are important to retail customers, although day-ahead and real-time markets may be sufficiently liquid to satisfy the commercial wants of generators and traders. ELCON supports any effort to develop liquid forward markets that, unlike day-ahead or

real-time markets, are more capable of sending price signals for the long-term investments in transmission and generation assets.

ELCON also believes that in regions without an operating ISO or RTO, (1) options and obligations be implemented and offered at the same time, and (2) an obligations-only market not be allowed to exist until a stakeholder process addresses the design of options. We fear that an obligations-only market may work to the disadvantage of some market participants (and to the commercial advantage of others). This may encourage the latter participants to use the stakeholder process to hold up the development of an options market or other SMD features. This concern is addressed in greater detail below under “Governance.”

Clearly, if the Commission deems FTR options an important element of its SMD, it is essential that existing ISOs and approved RTOs, that already meet many of the features of the SMD, be ordered to implement the options market coincident with other markets. The piecemeal phase-in of market features may unwittingly give some market participants an unearned commercial advantage.

#### **4. Bidding Rules**

We strongly endorse the *Working Paper's* support for new bidding rules. ELCON believes that centralized, bid-based markets are particularly vulnerable to generator market power because adequate price-responsive demand response may not be forthcoming given the opposition of many states to the participation of retail loads in wholesale markets. States retain the ability to trump even the best intentions of the Commission to create competitive, interstate wholesale markets because of their control over the actions of retail customers capable of bidding price-responsive resources. Demand response is an essential for checking the market power of merchant generators. Frank Wolak, the chairman of the California ISO's Market Surveillance Committee, explains the problem well:

All existing electricity markets in the US have failed to introduce the necessary demand-side incentives for setting the lowest possible prices for wholesale electricity consistent with the long-term financial viability of the industry. In the name of protecting consumers, state PUCs have denied consumers the ability to benefit from being active participants in the spot market. By handicapping the demand side of the market the PUCs are only increasing the likelihood that

wholesale suppliers will be able to raise prices through their own unilateral bidding and scheduling behavior.<sup>1</sup>

ELCON believes that comprehensive bidding rules are necessary to mitigate the ability of generators and traders to unilaterally manipulate the market-clearing prices of bid-based energy and capacity markets. Bidding rules should be designed to remove the economic incentive in bid-based markets for generators to withhold their power from forward markets and commit all their output to the day-ahead or real-time markets. In theory, this bias is mitigated with robust demand response. But, until that happens, strong bidding rules are essential.

Bidding rules must be designed to achieve a simple outcome: generator bids in any bid-based market must reflect actual marginal costs. Thus, it is less important how the bidding rules are designed because it is only the outcome that is important. FERC's policy in favor of centralized bid-based markets is fraught with a huge risk—the ability of generators and traders to unilaterally manipulate the market-clearing prices. The uniform price auction that sets the clearing price for resources that are ultimately dispatched will greatly magnify the financial consequences of any exercise of market power. Therefore, it is essential that generator market power is effectively mitigated before any generator is granted market-based rate authorization, and ELCON believes that market-based rates are only lawful if market power is mitigated.<sup>2</sup>

## **5. Allocation of FTRs**

The Commission has yet to determine the method for the initial allocation of FTRs. One option FERC is considering is to directly allocate transmission rights to customers that pay the embedded costs of the transmission system. Any transmission rights not claimed by these customers would be auctioned. Another option would be to conduct an auction to apportion the transmission rights, with the proceeds from the auction allocated to those customers that pay the embedded costs of the system. ELCON supports the first option that, in fact, combines features of both options. Customers that do not have a direct need for the FTRs—e.g., customers that

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<sup>1</sup> Frank A. Wolak, "Designing a Competitive Wholesale Electricity Market That Benefits Consumers," Department of Economics, Stanford University, October 15, 2001, page 53.

<sup>2</sup> See ELCON April 9, 2002 Motion to Intervene, State of California, ex. rel. Bill Lockyer v. British Columbia Power Exchange Corp., et al., Docket No. EL02-71.

remain under bundled retail service—may be better off by having them auctioned and accept the proceeds from the auction to offset any congestion costs incurred in bundled rates. In any event, in states that have unbundled retail sales, the customer should have the right of first refusal on the ownership of the FTRs necessary to serve their load.

## **6. Market Monitoring and Mitigation**

ELCON supports the direction articulated in the *Working Paper* on market monitoring and mitigation. We agree with the Commission that structural remedies are superior to behavioral remedies, but the Commission has limited ability to mandate corporate divestiture. We agree that market monitoring should focus on: (1) identifying market design flaws and market rule changes necessary to correct those flaws; and (2) identifying and mitigating anticompetitive behavior and the exercise of market power, primarily economic and physical withholding. We also strongly agree that ex ante mitigation is preferable to retroactive or ex post price changes. Industrial consumers that often make costly decisions based on an expected price can be seriously harmed if prices are retroactively revised. For example, demand response becomes almost unworkable if there is a chronic risk of after-the-fact downward price adjustments.

ELCON strongly supports RTO market monitoring units (MMU) that are independent of RTO staff. If the MMU staff is part of the ISO/RTO staff, there is the potential for peer pressure to prevent the MMU from publicizing anything that might embarrass the RTO. MMUs also must not be delegated enforcement authority. We fear that this might create a new layer of regulation that would evade normal checks and balances such as Congressional oversight. FERC must be the exclusive enforcer of its policies and rules.

## **7. Governance**

FERC is encouraging RTOs to have stakeholder advisory committees, ostensibly, to facilitate a stakeholder collaborative process for future changes to market design rules, the RTO tariff or other features of the RTO. The Commission must not allow any group of market participants to dominate the stakeholder process and use it to secure or preserve a commercial advantage. The Commission's SMD contains new market design elements that are intended to

make markets competitive. Existing markets in PJM and elsewhere have yet to implement these elements (*e.g.*, demand response and FTR options) and therefore those markets cannot be deemed competitive. In all existing stakeholder or advisory committees, the suppliers outvote end users (the demand side). Thus, the suppliers can collectively dictate the pace and substance of any changes to market rules or tariff. For example, ELCON members with major facilities in PJM have observed the intentional efforts of suppliers (*e.g.*, LSEs, generators and marketers) to prevent a credible demand response market from being created in PJM. Similarly, generators and marketers are advocating the implementation of FTR obligations in advance of the implementation of FTR options with the probable intent of using the stakeholder process to stall implementation of FTR options.

ELCON urges FERC to reconsider the role of stakeholder processes and if it deems such processes as a necessary and important adjunct to its adjudicatory responsibilities, then the Commission has a statutory responsibility to guarantee that such processes are fair and nondiscriminatory and not unduly preferential with respect to any market participants or class of market participants. Condoning the allocation of votes that allows a class of market participants to preserve or secure a commercial advantage does not do that. At a minimum, stakeholder processes must be established in which neither the wholesale side nor the retail side of the market has an upper hand. If votes count, votes must be allocated 50:50 between suppliers and end users.

Respectfully submitted,

/s/ John A. Anderson

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